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Introduction

Kieran discovered that he had a flair for fixing computers while studying for his A levels. He, therefore, decided that university was not for him. Instead, in 2007, with advice from his family, he had set up a computer repair business as a sole trader. Within four years he had built up a good customer base of private clients. In 2011 he 'joined forces' with Maryum, a computer solutions consultant, and they set up *Byte Solutions Limited*. It offers a collection and return computer repair service to private clients and IT solutions to small businesses in the local area. Kieran and Maryum each own 1800 shares, with Kieran's father owning 400. The total number of shares issued at £1 each is 4000. 5

In 2013 Kieran and Maryum had spotted an opportunity to offer an outsourcing service to their business customers. Business customers could 'share' IT technicians as opposed to employing one full time (i.e. an IT technician could spend a dedicated period of time each week at each of their allocated business customers' premises sorting out any IT problems). The outsourcing service could be further supplemented by a 24 hour call out service. In order to facilitate the outsourcing service, *Byte Solutions Limited* employed three IT technicians. Maryum manages the outsourcing service contracts, as well as continuing to work on IT solutions for business clients. Kieran works on computer repairs in the workshop and also supervises the technicians who undertake the outsourcing service. 10
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Byte Solutions Limited operates from small rented premises on a trading estate on the outskirts of a large town in the Midlands. The premises have a workshop, a room used for meetings with the three technicians, and a reception area, which also serves as the office for *Byte Solutions Limited*. In recent months *Byte Solutions Limited* has added a small selection of paper, ink and other small value consumable computer supplies to its reception area for customers to purchase by way of shop sales. 20

Byte Solutions Limited requires its outsourcing customers to pay a monthly technician fee by standing order. All shop sales are paid for at the time of sale. All other services are charged by the hour with payment required on receipt of an invoice. 25

Recently Maryum has found that business clients do not have the money to replace computer hardware and software and instead are seeking cheaper computer solutions. As a result Kieran and Maryum have decided to further expand *Byte Solutions Limited* to take advantage of this situation by offering a computer repair service to business clients. In order to successfully offer this service, *Byte Solutions Limited* would need to employ two more technicians to help Kieran carry out the repairs. 30

However the current premises occupied by *Byte Solutions Limited* are not large enough to house two more staff and the additional specialist computer equipment which will be needed to carry out the repairs. Kieran and Maryum have the opportunity to rent the small unit next to the existing premises which would double the space available (and double the rent). 35

Kieran's father, however, thinks it would make more sense to buy rather than to rent premises. Kieran, therefore has been looking for suitable premises to purchase and has found a building located about 15 miles away from where *Byte Solutions Limited* currently operates. This building would provide the opportunity to relocate the entire business. The building is in a rural location but it would provide more space than *Byte Solutions Limited* currently needs. The building is on the market for £120 000. Kieran is excited by the prospect of the business owning its own premises. Maryum, however is concerned about the cost of borrowing in order to finance such a large purchase as *Byte Solutions Limited* would need to borrow 80% of the purchase price. She is unsure of the benefits of purchasing compared to renting. 40
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TASK A

You are Kieran's cousin and are studying a financial unit as part of a business management qualification at college. He has asked you to write a report to help Maryum and himself improve their understanding of the need for and the importance of financial record keeping.

- (i) Kieran and Maryum currently do not fully understand the implications for a business if it fails to accurately record all its financial transactions. In your report you should explain the reasons why accurate financial records need to be kept. These include the need to:
- calculate accurately profit and loss
 - meet legal requirements
 - show the assets and liabilities of the business
 - compare the business' financial position to previous years
 - prepare accurate budgets/forecasts for future years
 - obtain additional finance
 - plan any future expansion.
- (ii) Kieran and Maryum are also unsure of the consequences to *Byte Solutions Limited* if its financial information is found to be inaccurate. To help Kieran and Maryum, you have been asked to explain the following consequences to *Byte Solutions Limited* of its financial information being inaccurate:
- criminal action
 - cash-flow problems from a high tax bill or criminal action
 - existing shareholders losing confidence
 - potential shareholders being unwilling to invest due to a lack of confidence in the business
 - bad public image
 - change in management structure.
- (iii) Kieran and Maryum do not understand some of the technical accounting language. They would welcome your explanation of different types of income and expenditure which are often included in a set of final accounts. You need to explain each of the following to them so that they can understand how and why the following are accounted for in the books:
- capital and bank loans
 - assets such as premises and vehicles, including items bought on credit
 - expenses for running a business, e.g. wages, electricity
 - items/services purchased for resale, including those bought on credit
 - items/services sold, including those sold on credit.

You should also include explanations of the following source documents and how they are used:

- invoices
- credit notes
- bank records, e.g. direct debits and till receipts.

- (iv) You must also explain to Kieran and Maryum how a series of final accounts are created from source documents, including the processes and financial documents used.

Your explanation must show your understanding of each of the following:

- the division of ledgers
- double-entry transaction recording
- the balancing of accounts accurately
- the creation of a trial balance
- the creation of a profit and loss account and a balance sheet.

These could be in written format and/or with the use of diagrams.

- (v) In your report to Kieran and Maryum you must explain the types of error which can occur when preparing accounts. You should include an example for each type of error to demonstrate depth of understanding. These include:

- omissions
- compensating errors
- errors of principle.

[On completion of TASK A you will be assessed on Assessment Objective 1 which has a 9 mark tariff]

Note: For the purposes of this stimulus material, VAT transactions and Corporation Tax have been ignored.

TASK B

At the start of trading on 1 April 2014, the following selected balances were extracted from the books of *Byte Solutions Limited*.

| | £ |
|---|---------|
| Palmer, Plumb and Greenwell Solicitors (Debtor) | 1 250 |
| Graygables Hotel and Conference Centre (Debtor) | 925 |
| Kneller & Brooke Accountants (Debtor) | 400 |
| Brook Laine Garage (Creditor) | 191 |
| Nuitparts (Creditor) | 1 185 |
| The Gadget Hatch (Creditor) | 1 735 |
| Sales | 237 126 |
| Purchases | 54 197 |
| Bank (Dr) | 38 327 |
| Cash | 30 |
| Rent and rates | 13 476 |
| Discount received | 263 |
| Discount allowed | 27 |
| Carriage inwards | 132 |
| Motoring expenses | 6 725 |
| Purchase returns | 332 |
| Insurance | 672 |
| Bank interest received | 21 |

During trading on 1 April 2014 the following source documents required processing.

| | | | |
|---------------------------|------|------|--|
| Sales Invoice | £731 | to | Palmer, Plumb and Greenwell Solicitors for software upgrades |
| Sales Invoice | £132 | to | Kneller & Brooke Accountants for cable re-routing |
| Sales Invoice | £90 | to | Graygables Hotel and Conference Centre for video conferencing set up and filming |
| Till Receipt (cash sales) | £151 | | Paid directly into the bank |
| Till Receipt (cash sales) | £20 | | Kept in till in cash form |
| Purchase Invoice | £325 | from | Nuitparts including carriage inwards of £5 |
| Purchase Invoice | £109 | from | Brook Laine Garage for vehicle repairs |
| Cheque issued | £70 | to | Brook Laine Garage for immediate payment for petrol |
| Cheque issued | £291 | to | Brook Laine Garage to clear its account after taking a 3% cash discount |
| Cheque received | £392 | from | Kneller & Brooke Accountants in settlement of £400 after taking a 2% cash discount |
| Purchase returns | £35 | to | Nuitparts |

In addition the bank statement shows:

| | | | |
|--------------------------|--------|------|---|
| Direct debit paid | £1 123 | to | Rent and rates (for rates payable to the local council) |
| Direct debit paid | £54 | to | Allova Insurance |
| Credit transfer received | £925 | from | Graygables Hotel and Conference Centre |
| Credit transfer received | £1 225 | from | Palmer, Plumb and Greenwell Solicitors after deducting a 2% cash discount |

You are required to:

- (i) open the relevant ledger accounts, ensuring the opening balances are clearly shown
- (ii) post the information from the source documents and the bank statement to the relevant ledger accounts
- (iii) balance off the accounts as at the close of trading on 1 April 2014
- (iv) bring down the balances ready for start of trading on 2 April 2014.

TASK C

On 18 April 2014 Maryum wanted to check that the books of *Byte Solutions Limited* balanced by producing a trial balance. She is aware that a suspense account may need to be created if the trial balance does not balance. She extracted the following balances as at 18 April 2014.

| | £ |
|--|---------|
| Sales | 283 684 |
| Purchases | 60 426 |
| Ordinary share capital @ £1 each | 4 000 |
| Retained profit | 1 653 |
| Motor vehicles (cost) | 24 760 |
| Provision for depreciation of motor vehicles | 7 428 |
| Equipment (cost) | 8 610 |
| Provision for depreciation of equipment | 2 150 |
| Discount received | 482 |
| Discounts allowed | 9 |
| Rent and rates | 14 399 |
| Purchase returns | 445 |
| Telephone | 630 |
| Electricity | 420 |
| Insurance | 1 635 |
| Advertising | 460 |
| Carriage inwards | 198 |
| Bad debts written off | 152 |
| Wages | 121 688 |
| Sundry expenses | 167 |
| Interest received | 29 |
| Stock at 1 May 2013 | 8 837 |
| Bank (Dr) | 46 186 |
| Cash | 50 |
| Motoring expenses | 7 978 |
| Creditors | 2 348 |
| Debtors | 2 155 |
| Dividends paid | 3 000 |

You are required to:

- (i) prepare the trial balance as at 18 April 2014 creating a suspense account, if appropriate

After preparing the trial balance, the following errors were found:

- 1 discounts allowed of £163 were credited to discounts received in error
- 2 the rent and rates account had been understated by £200
- 3 a purchase return of £29 had been correctly posted to the creditor's ledger but had been debited to purchases in error
- 4 included in the insurance account was £17 which related to telephone expenses
- 5 a cheque payment of £201 for garage repairs had been correctly recorded in the bank account but was entered in the motoring expenses account as £210.

- (ii) prepare a statement clearly showing how each of the above errors should be corrected. You should use journal entries and a suspense account
- (iii) prepare a corrected trial balance as at 18 April 2014.

TASK D

On 30 April 2014 the following balances were extracted from the books of *Byyte Solutions Limited*.

| | £ |
|--|---------|
| Sales | 291 252 |
| Purchases | 62 622 |
| Ordinary share capital @ £1 each | 4 000 |
| Retained profit | 1 653 |
| Motor vehicles (cost) | 24 760 |
| Provision for depreciation of motor vehicles | 7 428 |
| Equipment (cost) | 8 610 |
| Provision for depreciation of equipment | 2 150 |
| Discount received | 319 |
| Discounts allowed | 172 |
| Rent and rates | 14 599 |
| Purchase returns | 474 |
| Telephone | 720 |
| Electricity | 610 |
| Insurance | 1 850 |
| Advertising | 460 |
| Carriage inwards | 219 |
| Bad debts written off | 152 |
| Wages | 122 688 |
| Sundry expenses | 219 |
| Interest received | 35 |
| Stock at 1 May 2013 | 8 837 |
| Bank (Dr) | 49 674 |
| Cash | 50 |
| Motoring expenses | 7 978 |
| Debtors | 2 441 |
| Creditors | 2 350 |
| Dividends paid | 3 000 |

Additional information:

- 1 Stock as at 30 April 2014 is valued at £9 714.
- 2 *Byyte Solutions Limited's* rent and rates include a prepayment of £1 123.
- 3 There are accrued wages of £4 106 and accrued advertising of £140.
- 4 The wages include directors' remuneration of £60 000.
- 5 Depreciation per annum on motor vehicles is to be provided at 30% using the reducing balance method. Depreciation on equipment is provided at 20% using the straight line method.
- 6 A debtor has gone bankrupt owing *Byyte Solutions Limited* £237. This is to be written off. In addition Kieran and Maryum have decided that it would be prudent to set up a doubtful debt provision at 5% of the debtor's figure after the writing off of the bad debt.
- 7 *Byyte Solutions Limited* has proposed a final dividend of £50 000.

You are required to prepare in an appropriate professional format for *Byte Solutions Limited*:

- (i) a trading, profit and loss account and appropriation account for the year ended 30 April 2014
- (ii) a balance sheet as at 30 April 2014.

[On completion of TASKS B, C and D you will be assessed on Assessment Objective 2 which has a 14 mark tariff]

TASK E

Byte Solutions Limited is a private limited company.

- (a) Explain the key issues and potential pitfalls which a private limited company must consider when constructing its final accounts, particularly in relation to:
 - (i) possible templates and/or layouts
 - (ii) legal requirements.
- (b) Compare the summary reports which would be provided to shareholders by a public limited company with the information provided by a private limited company such as *Byte Solutions Limited*.

TASK F

The following ratios have been calculated from *Byyte Solutions Limited's* final accounts for the year ended 30 April 2013.

| | Year ended 30 April 2013 |
|----------------------------|-------------------------------------|
| Gross profit percentage | 81% |
| Net profit percentage | 24% |
| Return on capital employed | 495% |
| Current ratio | 1.69:1 |
| Acid test ratio | 1.10:1 |
| Stock turnover | 91 days |
| Debtor collection period | 2 days |
| Creditor payment period | 18 days |
| Earnings per share | £18 |
| Dividend cover | 3 times |

Note: For the purpose of your calculations 100% of *Byyte Solutions Limited's* purchases are on credit and 90% of sales are on credit for the years to 30 April 2013 and 30 April 2014.

You are required to:

- (i) using the formulae provided in Appendix 1, calculate (where appropriate to two decimal places) relevant ratios from *Byyte Solutions Limited's* final accounts for the year ended 30 April 2014
- (ii) analyse and interpret these ratios, taking into account the limitations of using ratios to make decisions about the financial viability of a business, in order to comment on the financial position of *Byyte Solutions Limited*.

[On completion of TASKS E and F you will be assessed on Assessment Objective 3 which has a 12 mark tariff]

TASK G

Kieran and Maryum are pleased with how *Byyte Solutions Limited* is developing and its success to date. Although they have plans for the future of *Byyte Solutions Limited*, they are unsure of the best way to finance these plans.

You are required to:

write a report to Kieran and Maryum recommending how to finance the future plans of *Byyte Solutions Limited* including:

- the premises
- the specialist computer equipment
- the recruitment, wages and possible training of two more IT technicians
- increased stock levels.

In addition you are required to include within your report advice on how Kieran and Maryum could improve the liquidity management of *Byyte Solutions Limited*.

Justify your recommendations.

[On completion of TASK G you will be assessed on Assessment Objective 4 which has a 15 mark tariff]

Appendix 1

Accounting Ratios

Profitability

| | | | |
|--|-------|---|-----------------------------------|
| $\frac{\text{Gross Profit}}{\text{Net Sales}}$ | × 100 | = | Gross Profit Percentage |
| $\frac{\text{Profit before Tax}}{\text{Net Sales}}$ | × 100 | = | Net Profit Percentage |
| $\frac{\text{Profit before Tax}}{\text{Capital Employed}}$ | × 100 | = | Return On Capital Employed |
| $\frac{\text{Expenses}}{\text{Net Sales}}$ | × 100 | = | Expenses as a Percentage of Sales |

Solvency/Liquidity

| | | | |
|---|--|---|-----------------|
| $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ | | = | Current Ratio |
| $\frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}}$ | | = | Acid Test Ratio |

Performance

| | | | |
|--|-------|---|---------------------------------|
| $\frac{\text{Average Stock}}{\text{Cost of Sales}}$ | × 365 | = | Stock Turnover (days) |
| $\frac{\text{Net Sales}}{\text{Fixed Assets (NBV)}}$ | | = | Fixed Asset Turnover |
| $\frac{\text{Closing Debtors}}{\text{Credit Sales}}$ | × 365 | = | Debtor Collection Period (days) |
| $\frac{\text{Closing Creditors}}{\text{Credit Purchases}}$ | × 365 | = | Creditors Payment Period (days) |

Shareholder

| | | | |
|--|--|---|--------------------|
| $\frac{\text{Profit attributable to ordinary shareholders}}{\text{Number of ordinary shares}}$ | | = | Earnings per share |
| $\frac{\text{Earnings per share}}{\text{Net dividend per share}}$ | | = | Dividend Cover |

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